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FISCAL IMPACT STATEMENT

LS 7080 **NOTE PREPARED:** Feb 2, 2005
BILL NUMBER: HB 1728 **BILL AMENDED:**

SUBJECT: Update of References to the Internal Revenue Code.

FIRST AUTHOR: Rep. Espich **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: The bill provides that for taxable years beginning after December 31, 2004, references in Indiana law to the Internal Revenue Code and related regulations refer to the law and regulations in effect on January 1, 2005.

Effective Date: January 1, 2005 (retroactive).

Explanation of State Expenditures:

Explanation of State Revenues: The bill updates the reference to the Internal Revenue Code (IRC) to incorporate all the federal changes made up to January 1, 2005. The update would include changes affecting tax years 2005 and after as a result of the following federal acts:

(1) the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 (P. L. 108-27)
(2) the Military Family Tax Relief Act (MFTRA) of 2003 (P. L. 108-121)
(3) the Working Families Tax Relief Act (WFTRA) of 2004 (P. L. 108-311)
(4) the American Jobs Creation Act (AJCA) of 2004 (P. L. 108-357).

A summary of the estimated revenue impact of these federal acts is outlined in the table below. A general explanation of the provisions follows the table. It is important to note that current statute provides for an addback of Federal bonus depreciation allowances claimed during the taxable year for Federal income tax purposes so any references to this provision in the above acts will not affect the Indiana tax base.

Provisions (Revenue Impact in $M)	FY 2005	FY 2006	FY 2007
Jobs & Growth Tax Relief Reconciliation Act of 2003			
(1) Increase Sec. 179 Expensing Limit (thru 2005)	**(10.8)**	**(3.6)**	**0**
Military Family Tax Relief Act of 2003			
(1) National Guard Travel Expense Deduction	**(0.3)**	**(0.4)**	**(0.4)**
Working Families Tax Relief Act of 2004			
(1) Educator Expense Deduction	(0.8)	(0.9)	(0.2)
(2) Clean-Fuel Vehicle Deduction	(0.2)	(0.1)	0
(3) Corporate Computer Contribution Deduction	(0.8)	(0.5)	(0.1)
(4) Expensing Environmental Remediation Costs	(1.6)	(0.9)	0
Subtotal	**(3.4)**	**(2.5)**	**(0.3)**
American Jobs Creation Act of 2004			
(1) Repeal of Extraterritorial Income Exclusion	1.4	5.6	15.4
(2) Manufacturer's Production Activities Deduction	(8.0)	(14.5)	(21.0)
(3) 85% Foreign Source Dividend Deduction	11.9	(5.1)	(8.4)
(4) Extension of Increase Sec. 179 Expensing Limit (thru 2007)	0	(10.4)	(21.5)
(5) S-Corporation Tax Treatment	(0.1)	(0.2)	(0.3)
(6) Business Tax Incentives and Miscellaneous Business Provisions	(2.2)	(2.6)	(2.4)
(7) Revenue Provisions	6.0	10.5	13.1
Subtotal	**9.0**	**(16.7)**	**(25.1)**
Total Impact on State Revenue	**(5.6)**	**(23.2)**	**(25.9)**

Jobs and Growth Tax Relief Reconciliation Act of 2003:

(1) Temporarily increases the amount that a small business can expense (under Section 179 of the IRC) in the first year for depreciable property placed in service during the year from $25,000 to $100,000. The increased threshold applies to depreciable property placed in service in tax years 2003 to 2005. The increase would be effective for Indiana purposes only for property placed in service during tax year 2005. The increase expires after tax year 2005. The $100,000 threshold is reduced when the cost of qualified depreciable property placed in service during the tax year exceeds $400,000. Both the expensing cap(equal to $102,000 in tax year 2004) and the property cap (equal to $410,000 in tax year 2004) are indexed for inflation.

Military Family Tax Relief Act of 2003:

(1) Creates an above-the-line deduction for travel expenses of National Guard troops and reservists, provided the travel exceeds 100 miles and requires an overnight stay. The deductible expenses may not exceed the general federal per diem rate applicable to the particular locality.

Working Families Tax Relief Act of 2004:

(1) Extends through tax year 2000 the above-the-line deduction for qualifying expenses incurred by educators for classroom materials (which expired after tax year 2003) through tax year 2005.

(2) Provides for the full value of the existing above-the-line deduction for clean-fuel vehicles placed in service in tax year 2005. Under prior law, the deduction was scheduled to be reduced by 50% for property placed in service in tax year 2005. Pursuant to current law, the deduction will be reduced by 75% for property placed in service in tax year 2006, and will expire after tax year 2006.

(3) Extends the corporate deduction for charitable contributions of computer technology or equipment to elementary and secondary schools, and public libraries (which expired after tax year 2003) through tax year 2005.

(4) Extends the deduction for expenses relating to the cleanup of hazardous substances in certain qualified areas (which expired after tax year 2003) through tax year 2005.

American Jobs Creation Act of 2004:

(1) Phases-out the exclusion from gross income for extraterritorial income a U. S. business receives from sales of goods it produces domestically and sells abroad either directly or through a subsidiary. The phase-out of the exclusion begins in tax year 2005 and is generally complete beginning in 2007.

(2) Phases-in a new deduction from gross income for income a U. S. manufacturer receives from domestic production activities. The deduction is applicable to individual and corporate taxpayers, and pass through entities. Qualifying producers include traditional manufacturing, construction, engineering, energy production, computer software, films and videotape, and process of agricultural products. In tax years 2005 and 2006, the deduction is equal to 3% of the lesser of: (1) qualified production activities income for the year, or (2) taxable income for the year. The deduction increases to 6% for tax years 2007 through 2009, and to 9% for tax years 2010 and after. The deduction is limited to 50% of the W-2 wages paid by the producer during the tax year.

(3) Provides for a one-time deduction from gross income for a U. S. corporation that receive qualified dividends from a foreign corporation it controls, generally, during tax year 2004 or 2005. The deduction is equal to 85% of the amount of qualified dividends paid during the allowed time period. The dividends must be reinvested in the U. S. to fund worker hiring and training, infrastructure, research and development, capital investments, or financial stabilization of the corporation.

(4) Extends the increase in the small business expensing amount from $25,000 to $100,000 (under Section 179 of the IRC) for depreciable property placed in service during tax years 2006 and 2007. The increase expires after tax year 2007. (See discussion above under *Jobs and Growth Tax Relief Reconciliation Act of 2003.*)

(5) Provisions relating to tax treatment of S-corporations, including: (a) increasing the maximum allowable shareholders from 75 to 100; (b) treating family members as one shareholder for purposes of an S-corporation; and (c) permitting IRAs to hold shares in a bank that is an S-corporation.

(6) Provisions modifying certain depreciation and accounting rules, and treatment of certain business income and expenses, including: (a) acceleration of the recovery period for certain leasehold and restaurant building improvements; (b) deduction for certain reforestation costs; and (c) 75% first year expensing (in lieu of annual depreciation deductions) of capital costs incurred by small business refiners to comply with the diesel fuel sulfur controls imposed by the U. S. EPA.

(7) Provisions that increase taxpayer's federal adjusted gross income or taxable income, including limits on: (a) expatriation of income; (b) deductions for property leased to tax-exempt entities; (c) certain transfers of partnership losses; (d) deductions for charitable contributions of intellectual property; (e) deductions for certain entertainment expenses relating to use of company aircraft; and (f) Section 179 expensing of SUVs, and certain trucks and vans.

Explanation of Local Expenditures:

Explanation of Local Revenues: The IRC update could potentially affect taxable income of individual taxpayers, however, the impact on counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) is likely to be minimal.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: U. S. Congress, Joint Committee on Taxation, http://www.house.gov/jct/tableofcnts.html;
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